Editor's note: Appealed -- remanded, (for hearing) Civ. No. 75-2396 (E.D.La. Apr. 13, 1977)

GULF OIL CORP. ET AL.

IBLA 75-197 Decided June 16, 1975

Appeal from a decision by the Acting Director, United States Geological Survey, demanding payments for minimum royalties for oil and gas leases OCS 0786 and OCS-G 1191 (GS-58-O&G).

Affirmed.

1. Oil and Gas Leases: Royalties

   The minimum royalty required under an oil or gas lease following discovery, but prior to actual production, of oil or gas, must be satisfied; if advance royalties have been paid on take or pay payments made to a lessee-seller by a buyer in lieu of receiving production from the lease, they may be credited to the amount due for royalties on actual production in subsequent years, but only to the extent they are in any year in excess of the amount of the minimum royalties prior to actual production.

2. Administrative Authority: Estoppel -- Federal Employees and Officers: Authority to Bind Government -- Oil and Gas Leases: Royalties

   Generally, the Government is not estopped from demanding oil and gas lease royalty payments it is owed, even if its employees may have made prior mistakes in accepting or computing the royalty.

APPEARANCES: William G. Duck, Esq., John E. Bailey, Esq. (on briefs only) Law Department, Gulf Oil Company, Houston, Texas, for appellants; Scott McElroy, Esq., Office of the Solicitor, U.S. Department of the Interior, for Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE THOMPSON

This appeal by Gulf Oil Corporation and Mobil Oil Company is from a decision by the Acting Director, United States Geological

Survey, dated September 5, 1974, affirming a decision by the Oil and Gas Supervisor, Gulf Coast Region, dated March 12, 1969, demanding payments to meet outstanding minimum royalty obligations for oil and gas leases OCS 0786 and OCS-G 1191.

Pursuant to request by the appellants, oral argument was granted and heard before this panel of the Board on May 15, 1975. The basic facts in this case are not in dispute.

The leases were issued under authority of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1311 et seq. (1970). Each lease was for 5,000 acres. Lease OCS 0786 was issued May 1, 1960, for Block 48 South Marsh Island, and lease OCS-G 1191 was issued June 1, 1962, for Block 34 South Marsh Island, offshore Louisiana. Discoveries of oil and gas on lease OCS 0786 and on lease OCS-G 1191 were made on March 25, 1961, and June 1963, respectively. Oil production and sales from OCS 0786 and OCS-G 1191 began on May 23, 1966, and June 1, 1967, respectively.

The leases have the standard terms for rental and royalties. They are set forth in Section 2(d) of the leases pertaining to a lessee's duties as follows:

> (d) Rentals and royalties. - (1) To pay rentals and royalties as follows:
>
> Rentals. - To pay the lessor on or before the first day of each lease year commencing prior to a discovery of oil or gas on the leased area, a rental of $3.00 per acre or fraction thereof.
>
> Minimum royalty. - To pay the lessor in lieu of rental at the expiration of each lease year commencing after discovery a minimum royalty of $3.00 per acre or fraction thereof or, if there is production, the difference between the actual royalty paid during the year and the prescribed minimum royalty, if the actual royalty paid is less than the minimum royalty.
>
> Royalty on production. - To pay the lessor a royalty of 16-2/3 percent in amount or value of production saved, removed, or sold from the leased area. Gas of all kinds (except helium, and gas used for purposes of production from the operations upon the leased area or unavoidably lost) is subject to royalty.

As appellants indicate, the dispute involved in this appeal arises because of the existence of the "take or pay" provision of a gas contract between appellants and Transcontinental Gas Pipeline

Company (Transco). By the terms of a gas sales contract dated April 4, 1961, between appellants and Transco, they "dedicated" to Transco certain gas reserves within the leaseholds. The contract provided in Article V(1)(2) that should Transco fail to take available gas from the contract area during a "contract year", Transco would pay the lessees a sum certain for all the available gas not taken by it. The contract further provided, in Article V(4), that should Transco pay pursuant to this "take or pay" clause, Transco would have the right to recoup the amounts so paid at a later time in the event that the volume of gas taken by Transco from the contract area exceeded certain specified volumes. Transco failed to take gas made available to it by the lessees during portions of the "lease years" involved here.

With respect to lease OCS 0786, the lessees made a $15,000 minimum royalty payment for each of the lease years which commenced:

(1) May 1, 1961
(2) May 1, 1962
(3) May 1, 1963.

These payments are not disputed.

In a letter dated February 20, 1964, the Acting Gas Supervisor, Gulf Coast Region, United States Geological Survey, told Gulf:

> Your gas sales contract dated April 4, 1961, covering the sales of gas from the Vermilion, South Marsh Island, and Ship Shoal Areas to Transcontinental Gas Pipe Line Corporation stipulates in Article V. 1(a) that * * * `Buyer agrees to take or pay for, if available and not taken, Seller's interest in a minimum of one hundred thousand (100,000) MCF per day * * *' during the first year following date of first delivery.
>
> Your monthly Reports of Operation (form 9-152) submitted to this office for the period from July 1, 1962, to June 30, 1963, discloses that the buyer did not take the minimum quantity of gas contracted for, and therefore was obligated to pay for the quantity not taken under the terms of the gas sales contract. Also, your Lessee's Monthly Reports of Sales and Royalty (form 9-153) submitted for the above period do not reveal any royalty payments on amounts that may have been collected from the buyer for gas paid for but not taken. <u>You are reminded that royalties are due and payable on amounts collected for gas paid for even though not taken</u>. [Emphasis added.]

On February 24, 1964, Gulf responded that "[a]s the gas paid for was not produced, we had assumed that royalty is not due or payable at this time but that such royalty would be due and payable when the gas is produced and delivered to Transcontinental." Gulf also requested that Survey furnish it the material on which the conclusion was based that the royalty was due.

The Supervisor's response indicated that the request for payment was based on two factors. The first factor, a letter from then Secretary of the Interior Udall to Pan American Petroleum Corporation, pertaining to a different lease, said in part:

> Federal royalties for the term of the contract will be computed in accordance with the following:
>
> 1. Contract price, escalated, subject to modification to conform with approved Federal Power Commission price.
>
> 2. Royalty shall be paid currently on the total receipts to seller in the event Buyer elects to pay but not take gas under the take or pay clause. If, later, Buyer takes additional gas as make-up gas for such under purchase, and if such make-up gas should be subject to a higher contract price, royalty shall be paid on the difference.

The second factor mentioned in the letter is 30 CFR 250.64 (1964). That regulation provides:

> Value basis for computing royalties.
>
> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field or area, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. * * * [Emphasis added.]

Both of the factors appear, as applied by Survey, to treat royalty based on take or pay as royalty based on production.

On May 5, 1964, Gulf responded that royalty was due only on gas produced, saved and removed from the leased area, and that take or pay gas from shut-in wells is not in that category. Despite its position, because it expected that the gas already paid for would be delivered to Transco "in due course," Gulf submitted payment of $468,400.12 as "advance royalty." The royalty was computed on the basis of take or pay payments in the period from July 1, 1962, to June 20, 1963. No reference was made in the exchange of letters to the previously paid minimum royalty.

For the lease year commencing May 1, 1964, the lessees paid $16,720 in take or pay royalty, but paid no minimum royalty. For the lease year commencing May 1, 1965, the lessees paid $44,989.03 in take or pay royalty, but paid no minimum royalty.

Gas production and sales from lease OCS 0786 commenced on May 23, 1966. Survey's subsequent review of the leasehold account disclosed that the lessees had deducted the entire amount of its prepayments from subsequent gas sales reports and royalty payments. From this action the Survey concluded that there was no money in the lease accounts to satisfy the minimum royalty obligations under the lease, totalling $30,000, for the lease years which began May 1, 1964, and May 1, 1965. Under protest, the lessees submitted $30,000 to satisfy the minimum royalty requirements, and appealed the decision.

With respect to lease OCS-G 1191 an annual rental of $15,000 was paid for the period beginning June 1, 1963. This payment is not in dispute. Shortly thereafter lessees completed several producing wells on the leasehold. No dispute is raised as to royalties paid on production for the lease years June 1, 1964, to May 31, 1965, and June 1, 1965, to May 31, 1966. For lease year June 1, 1966, to May 31, 1967, the lessee paid $26,741.26 as royalty on "take or pay" payments and $5,186.89 as royalty on gas production, for a total of $31,928.15. Survey demands $9,908.94 to complete the minimum royalty for the lease year June 1, 1966, to May 31, 1967. Appellant has paid that amount under protest and appealed.

The basic position of Survey and of the appellants is set forth in their pre-oral argument statements of the issues presented. Counsel for Survey poses the issue and its position on the issue as follows:

> Whether monies paid to the United States on the basis of monies paid to Federal oil and gas lessees for gas which was not timely taken under a take-or-pay clause in a gas sales contract constitute `actual royalty' during the lease year in which the monies were paid which offset the requirement to pay minimum royalty in that year.

> It is the position of the appellees that the resulting payments to the United States are not actual royalty payments during the lease year in which the monies were paid and do not offset the requirement to pay minimum royalty in that year.

Survey's position is more fully set forth in Appendix A.

On the other hand, appellants pose the issue thusly:

> Under the facts and circumstances presented, is the lessor entitled to `minimum royalty' when for the years in question Lessor has demanded and received actual royalty under the lease provisions in excess of the amount specified in the minimum royalty provisions of the lease.

Appellants, in requesting a refund of the payments submitted under protest, i.e., the $30,000 for lease OCS-0786 and the $9,908.94 for OCS-G 1191, contend generally that those amounts are in excess of the amount required under the law and lease terms. Their specific analysis and arguments are set forth in Appendix B.

Basically, appellants contend that if the lessor has received a payment during a given lease year sufficient to cover the minimum royalty obligation, that obligation has been satisfied for the year, and that it does not matter whether the payment was for take or pay payments or for actual production. They contend it is irrelevant if they deduct the entire payment in later years as a credit for the amounts paid to the lessor. However, Survey's position is that the crediting of the payments is relevant to determine whether the full royalty obligation has been satisfied for the entire period in question.

It is evident that had Survey not demanded a payment for the take or pay payments received by the appellants for the lease years in question, the minimum royalty payments demanded by Survey now would have had to have been paid by appellants for those years. Essentially what we have before us is a request by appellants that such payments need not be paid now because the United States has had the use of the money on the take or pay payments made during the lease years when the wells were shut-in. Thus, appellants' counsel argued orally, the United States is estopped to demand the minimum royalty for those years.

Appellants did not appeal from the Oil and Gas Supervisor's original demand that they submit royalties based on the take or pay payments received from Transco. We, therefore, do not properly have before us two issues which touch the issues raised by the appeal because appellants have not timely nor properly raised them. They are:

1. Did Survey have authority to demand royalties from the lessee-seller on take or pay payments made by a buyer in lieu of receiving gas from the seller under a take or pay contract?

2. Assuming, arguendo, that Survey had no such authority, would appellants be entitled to deduct the interest value for such payments as a set off or credit on royalties due to the United States?

We pose these questions but need not and do not decide them. The questions do, however, serve to focus part of the problem. If appellants had not been required to pay a royalty on the take or pay payments, it appears that over the period involved they would have paid the same total amount as they have now paid on actual production plus the minimum royalty payments demanded by Survey. The only difference would be that they would have had the interest value on that amount of money representing the difference between the minimum royalty and the take or pay payments made during the years in question. However, under appellants' position, the take or pay payments could be made for a period and, if greater than the minimum royalty, would extinguish the minimum royalty obligation altogether; yet, in subsequent years, they could take the entire take or pay payments as credit against royalties on actual production without limitation. The effect of this would be to eliminate minimum royalty payments entirely so long as advance payments were made prior to actual production by the take or pay contract device.

[1] We agree with Survey that the entire amount of the take or pay royalty payments cannot be used as a credit against royalty on actual production in subsequent lease years, but only that amount over the minimum royalty obligation for the years prior to actual production. In other words, regardless of the propriety or impropriety of Survey's demanding royalties on the take or pay payments received by the lessees from their buyer prior to actual production, the minimum royalty obligation for the years prior to actual production must be satisfied. Whether the take or pay payment is deemed an advance royalty or prepayment for royalty or whatever nomenclature is used does not matter. Under the lease terms the minimum royalty was due at the end of each lease year beginning after discovery. If there was production, minimum royalty would only be due on the difference between actual royalty paid and the prescribed minimum royalty if the actual royalty was less than the minimum royalty. Where there was no production, the entire minimum royalty was required for those years despite the take or pay payments.

[2] Appellants' contention that Survey should be estopped to demand the payments to cover the minimum royalty obligations must rest partly upon an assumption that the original demand was improper. As we have indicated, appellants' failure to appeal from the Oil and Gas Supervisor's decision in accordance with the rules of practice of this

Department leaves that issue closed. In any event, there was no representation in the Supervisor's decision that the entire take or pay payments could be credited against future royalties on actual production in subsequent years, as appellant contends. The elements of estoppel are not present in this case so as to bar the Government from demanding royalty payments it is owed, even if its employees made prior mistakes in accepting or computing the royalty. Atlantic Richfield Co. v. Hickel, 432 F.2d 587, 591 (10th Cir. 1970), aff'g, Sinclair Oil and Gas Co., 75 I.D. 155 (1968); Marathon Oil Company, 16 IBLA 298, 81 I.D. 447 (1974), suit pending, Marathon Oil Company v. Morton, et al., Civil No. C 74-179, in the United States District Court for the District of Wyoming. We see no reason to warrant this case coming within any exceptions to this general rule. Nor do we see any other valid reason to excuse the nonpayment of the minimum royalty here. Therefore, we uphold Survey's decision.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision below is affirmed.

Joan B. Thompson
Administrative Judge

We concur:

Martin Ritvo
Administrative Judge

Edward W. Stuebing
Administrative Judge

APPENDIX A

In the Acting Director's decision, the rationale for Survey's position is as follows:

"Under Section 2(d)(1) of leases OCS 0786 and OCS-G 1191, the Supervisor is only authorized to credit royalties paid on actual production during a lease year against the minimum royalty prescribed. `Actual royalty' as that term is used in the lease applies only to royalty on actual production. Royalties accrue under the lease `in amount of value of production saved, removed, or sold from the leased area.' Here there was no production and no basis for which royalties would accrue.

"In the absence of actual production during any lease year the minimum royalty required by the contract must still be paid. Any payments to the United States during a lease year over and above the minimum royalty payments required by the terms of the lease constitute the only credits to which the lessee is entitled to apply to future royalties on actual production.

"Therefore, when monies are paid to the United States because the Federal Lessee is paid for gas which is not timely taken under the take-or-pay clause of a gas sales contract, the Lessee may withhold future royalty payments on gas credited against the amount of take-or-pay monies paid to the United States only so long as such payments represent monies paid in excess of the minimum royalty payments required for the lease year in which the take-or-pay monies were paid to the United States.

"The fact that appellants requested and were granted two successive one-year suspensions of production for lease OCS 0786 covering the lease years beginning May 1, 1965, and May 1, 1966, would seem to clearly demonstrate that neither the appellants nor the Supervisor believed that the monies paid under the take-or-pay provisions of the gas sales contract prior to the initiation of actual gas sales constituted payments on production under the terms of the leases involved. Had such payments constituted production or actual royalty payments, the aforementioned requests would have been unnecessary.

"In the absence of leasehold production, there can be no `actual royalty' credited against the minimum royalty prescribed in the lease. Thus, in the absence of production, `* * * the difference between the actual royalty paid during the year and the prescribed minimum royalty * * *' would equal the prescribed minimum royalty.

"To hold, as appellants would have us hold, that payments made to the Lessor on the basis of monies received during a lease year for gas which was not timely taken under a take-or-pay contract constitute

`actual royalty' during the lease year in which such monies are paid, even though such payments may be subject to recoupment during a subsequent lease year, would only serve to nullify the minimum royalty provisions of OCS leases. A decision such as that would fail to recognize that the minimum royalty provisions of OCS leases serve as an incentive to encourage lessees to initiate leasehold production and sales as soon as practicable following the discovery of oil and/or gas.

"We see no authority supporting appellants' views either in the language of the leases or the oil and gas regulations. The decision reached by the Supervisor is the only one that can be reached under the controlling provisions of the Federal leases and the operating regulations. * * *"

APPENDIX B

As stated in their brief on appeal, appellants contend, in part, as follows:

"The Lessor is not authorized by the leases to require payment of additional sums as `minimum royalty' under the circumstances involved in this appeal. * * * It is self-evident that the underlying purpose of the minimum royalty provision in the leases is to guarantee the Lessor a minimum annual income from the leased area. As stated in R. HEMINGWAY, THE LAW OF OIL AND GAS § 7.6 (1971): `The minimum royalty clause is used in instances where the landowner desires that cash payments for royalty be maintained at a minimum level, where the actual production would designate a lesser royalty, and where the landowner has sufficient bargaining power to cause the insertion of the clause.' In the case at bar, that minimum level is $15,000 for each `lease year' following discovery of oil or gas on the leased area. For the `lease years' May 1, 1964 to April 30, 1965 and May 1, 1965 to April 30, 1966 for lease OCS 0786 the Lessor was paid royalty in the amounts of $16,720.33 and $44,989.03 respectively. For the `lease year' June 1, 1966 to May 31, 1967 for lease OCS-G 1191 the Lessor was paid $26,741.26 in royalty on `take or pay' moneys and $5,186.89 (the Lessor only admits to a payment of $5,091.06) in royalty on production saved and removed from the leased area. Thus more than the minimum amount of royalty was paid to the Lessor during those `lease years' and the minimum royalty clause was satisfied. Additionally, the Lessor pursuant to its interpretation of the lease, was paid $468,400.12 in royalty on other `take or pay' moneys. Because the Lessor elected to receive its royalties in advance and construed the leases in such a way to achieve this, it had use of the moneys, some $556,850.74, for a substantial period of time. Even if calculated at a relatively low rate of interest, the use of those moneys was quite valuable to the Lessor; the Lessor's attempt to move the payment of the royalties from the years they were actually paid to the years in which the gas was produced so as to leave the minimum royalty `underpaid' obscures the fact that the Lessor had the use of the moneys over such period of time. Clearly the function of the minimum royalty to provide the Lessor with a minimum income from the leases in question was amply satisfied. The fact that at a later time the Lessees took a credit for the amounts paid the Lessor is entirely irrelevant to a determination of whether the Lessor received its guaranteed annual income for any of the years in which the actual royalty was paid.

"This dispute has arisen because the Supervisor and now the Director have taken the position that the royalty paid to the Lessor on the `take or pay' moneys is not `actual royalty' as used in the `minimum royalty' clause of the leases. The arbitrary and unreasonable character of this position is obvious when the lease terms and the background of this dispute are considered.

"A simple perusal of the leases demonstrates that two types of royalty were contemplated by the parties to the leases, a royalty

on production, and a royalty in an amount to make up the difference between the royalty on production, if any, and the amount prescribed in the leases as the `minimum royalty' - in this instance $15,000.00 for each leased area. The effect of decision GS-58-O&G is to create three types of royalty: a `minimum royalty' which is in essence a penalty on Lessees for failure to produce oil or gas; an `actual royalty' which is a `royalty on actual production' and which is the only royalty payment that can be credited against the `minimum royalty' owed by a Lessee; and a `royalty on production' which is the basis for requiring payment of `royalty' on `take or pay' moneys. The Director is forced into making an implicit distinction between `actual royalty' (i.e. `royalty on actual production') and `royalty on production' because of the earlier position of the Supervisor, and the Secretary of the Interior, in requiring that royalty be paid on the moneys received by Appellants under the `take or pay' provision of the gas sales contract with Transco. The only basis under the terms of the leases for the Lessor to collect a portion of the `take or pay' moneys was to deem the payment `royalty on production.' There is no other provision in the leases for collecting royalty on `take or pay' moneys. At the time the Lessor first attempted to collect these payments, Gulf Oil Corporation, on behalf of Appellants, took the position that no payment was due because there had been no production yet. The Lessor rejected this position and demanded payment of the moneys under the `royalty on production' clause of the lease; the Supervisor's letter of March 3, 1964 [Exhibit 1] expressly relies upon 30 CFR § 250.64 which specifies the method for determining the value of production.

"Now, however, the Lessor, through the Director's decision, does a complete about face. The Director's opinion states:

> "`Royalties accrue under the lease `in amount of production saved, removed or sold from the leased area'. Here there was no production and no basis for which royalties would accrue.'

Thus the Lessor now apparently adopts the position the Appellants previously asserted in resisting payment of royalty on `take or pay' payments. Either the Director has stated that the Lessor erred in collecting royalty on `take or pay' payments, or the Director's decision is to the effect that Appellants' royalty payments to the Lessor were `royalty on production' for purposes of one clause of the lease and not `royalty on production' for purposes of the `minimum royalty' clause of the lease. If the former is the Lessor's position then it is entirely arbitrary for the Lessor to use its own error in collecting the royalty on `take or pay' payments as the basis for collecting additional sums. If the latter is the Lessor's position, then its distinction between `actual royalty' (i.e. `royalty on actual production') and `royalty on production' is arbitrary and capricious and without support in the lease agreements.

Mention is made of `actual royalty' in the `minimum royalty' clause but only to distinguish between royalty on production and the royalty in an amount to make up the difference between the royalty on production and the minimum annual amount of royalty prescribed in the leases; `actual royalty' is used to avoid awkwardness of expression and in its context clearly means royalty on production. The Lessor collected the royalties as royalty on production and it was in fact an advance royalty on actual production. This clearly constituted `actual royalty' under any reasonable interpretation of the meaning of the term. It is a well established rule of interpretation that terms of an agreement are to be interpreted according to their plain meaning and so as to be consistent with one another. It is also a well established principle that omissions and ambiguities in contracts are construed most strongly against the party who prepared the instrument. This principle is not vitiated by the fact that, as here, the federal government - the Lessor - drafted the instrument. Standard Oil of California v. Hickel, 317 F. Supp. 1192 (D. Alaska), aff'd 450 F 2d 493 (9th Cir. 1970).

"The Lessor cannot, without denying the Appellants due process of law in taking their property, require payment of moneys on the basis that it is owed under the lease as royalty and then turn around and say that it is not royalty under the lease. To do so is arbitrary and capricious; it is a violation of the terms of the leases and a violation of the property and due process rights of Appellants under the Constitution.

"Apparently the Director of the Geological Survey is of the opinion that it is also the purpose of the minimum royalty provision to `serve as an incentive to encourage lessees to initiate leasehold production and sales as soon as practicable following the discovery of oil and/or gas.' It is one of the reasons why he has held Appellants must pay the amounts in question here. The obvious error of this position is manifest even in the Director's decision. The Director recognizes in his decision that the `take or pay' moneys were paid by Transco to Appellants because of Transco's failure to take timely gas it had contracted to purchase. Appellants had taken all the steps they could `to initiate leasehold production and sales as soon as practicable following the discovery of oil and/or gas.' The requirement that Appellants pay the sums in dispute could not serve as an incentive of the sort suggested by the Director, for the failure to take the gas was Transco's failure. Appellants were not responsible for there being no production from the leases in the `lease years' involved. The Director's decision is clearly erroneous in this respect.

"CONCLUSION

It has been shown that decisions of the Supervisor in requiring royalty to be paid on the `take or pay' moneys and in requiring additionally the payment of `minimum royalty' for `lease years' for which royalty payments exceeded the prescribed minimum amount are inconsistent. Since the Lessor insisted on receiving its royalties

in advance, it is submitted that the decisions of the Supervisor and the Director holding that Appellants were responsible for payment of a `minimum royalty' in addition to such royalties were erroneous and improper; they were contrary to the terms of the leases involved and resulted in an unlawful taking of the property of the Appellants in violation of the rights of Appellants under the Constitution of the United States. The decisions of the Supervisor and Director as appealed from herein should be recalled and set aside, and an appropriate order should be entered for the reimbursement of Appellants, Gulf Oil Corporation and Mobil Oil Company, for the sums they have paid under protest, some $39,908.94."